United States Court of Appeals for the Ninth Circuit.

No. 22507-A.

EVERETTE H. WILLIAMS,
APPELLANT,

v.

ROSE CITY DEVELOPMENT COMPANY, INC.,
APPELLEE.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF OREGON.

BRIEF AMICUS CURIAE OF THE PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE.

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Preliminary Statement.

Pursuant to the procedure established by the Permanent Editorial Board for the Uniform Commercial Code, the Board submitted an amicus curiae Brief to the District Court at its request. All parties to this appeal have consented in writing to the submission of this Brief to the Court of Appeals, which consents have been submitted to the Court. This Brief was prepared by the Subcommittee on Construction of the Permanent Editorial Board and approved by that Board. It is being filed for the Permanent

Editorial Board by the Oregon Commissioners on Uniform State Laws.

Statement of the Case.

On October 19, 1964, the Portland Newspaper Publishing Co., Inc. (the "Bankrupt"), successor by merger to Portland Reporter Publishing Co., Inc. (the "Reporter"), was adjudicated a bankrupt upon an involuntary petition filed on October 15, 1964, and consented to by the stockholders and directors of the Bankrupt.

At issue are claims of three creditors asserting security interests in the net proceeds of accounts receivable collected by a representative of the secured creditors appointed on September 28, 1964, approximately three weeks before the bankruptcy.

The District Court's decision affirms the finding of the Referee to the effect that claims of two of these creditors, one of whom, Mr. DuBay, claims $25,000 with interest from September 16, 1964, and the other, Mr. Davis, claims $25,000 plus interest from September 18, 1964, are unsecured for the reason that in neither case was there an effectual assignment of the accounts claimed (R. 102, 104, 57).

The Permanent Editorial Board takes no position on the correctness of these findings but assumes them to be correct in discussing the findings and conclusions of the District Court and the Referee relating to the claim of Rose City Development Company, Inc. ("Rose City").

The claim of Rose City totals $53,122.26, with interest at 6½% per annum on $10,300 from November 22, 1963, and interest on the remainder at the same rate from September 11, 1964 (R. 7, 34, 95). It is based on two promissory notes issued in November of 1963, one dated November 16, 1963, and the other November 22, 1963, both of which are secured

by a security agreement signed by the Reporter, dated November 22, 1963, and titled "Accounts Receivable Loan and Security Agreement" (Ex. 17).

Under this security agreement—

1. Rose City acquired a security interest in all present and future accounts and contract rights, underlying goods and merchandise and the proceeds thereof, except certain accounts "heretofore assigned" to Mr. DuBay. Rose City's security interest in certain other accounts was later subordinated to a security interest that might be acquired therein by Mr. Davis (Ex. 15).

2. Outstanding loans were not to exceed "75% of the net value of qualified collateral" (defined to include only billed accounts), and any financial statement showing loans in excess of this percentage was to be followed by the furnishing of additional collateral or cash payment of the difference.

3. The Bankrupt was permitted to collect and in practice to use the proceeds of the accounts with the reserved right in Rose City to take over collections at any time, a right which it exercised for a short period in February of 1964, as well as on September 28, 1964.

A financing statement signed by the Reporter was duly filed November 26, 1963, describing the collateral as "Accounts Receivable" but without check of the "Proceeds" box (Ex. 3).

On March 27, 1964, the Reporter and the newly organized Bankrupt, both being Oregon corporations, signed a merger agreement which provided that the Bankrupt would succeed to and possess "all of the rights, privileges, powers and immunities of the Reporter" and would be subject to "the liabilities and duties of the Reporter" (Ex. 19).

From June 15, the beginning of the four-month period prior to the bankruptcy, and up to September 28, when col-

lection of the accounts was taken over by a representative of the secured creditors, the balance of billed accounts never went below the low of $129,482.50 on June 27. The balance stood at $144,255.70 on June 15, and at $141,463.48 when the representative undertook collections on September 28 (Ex. 39).

Additional billings of $71,061.90 were made thereafter, $25,939.75 of which represented accounts resulting from the sale of advertising, the remainder being circulation accounts, or accounts resulting from the sale of newspapers (Ex. 39). The Bankrupt suspended publication on September 30. The collections of the representative of the secured creditors totalled $126,829, of which $107,000 was left after deducting the costs of collection (R. 6, 91).

The amounts which the secured creditors permitted the Bankrupt to collect and use in the same period (June 15 to September 28) and the billings by the Bankrupt during the same period are shown on a bi-weekly basis in the table set out on page 41 of the Appendix, with a column reflecting the effect of such collections and new billings on the balance of unpaid billings. From this table, which is derived from Exhibit 39, it can be seen, and Judge Solomon found (R. 100), that the Bankrupt collected and used $397,860.24 worth of accounts which were subject to Rose City's security interest, which collections were presumably used to pay wages and other current operating expenses of the Bankrupt. During this same period the collateral was replaced with a slightly lower volume of billings.

The Referee concluded that Rose City's security interest in the replacement accounts was voidable as a preference under Section 60 of the Bankruptcy Act, 11 U.S.C. § 96 (R. 58, 59). Both he and the Trustee suggested, however, that if Rose City had exercised dominion over the collateral in the manner required by the law of Oregon before the en-

actment of the Uniform Commercial Code, there would have been no preference (R. 98). The District Court properly concluded that there was no preference on at least three separate grounds, *any one of which* is sufficient to support the conclusion. These three grounds involve the three principal questions raised by the foregoing facts, each of which was answered in the affirmative by the District Court.

Questions Presented.

1. Where, within four months of the bankruptcy of the debtor, Rose City (*a*) releases to the debtor the proceeds of accounts receivable in which Rose City has a valid and perfected security interest, (*b*) does so contemporaneously with or subsequent to the creation of new acccounts receivable which are subject to Rose City's security interest, but (*c*) does not take possession of or exercise "dominion" over the proceeds before they are released, is the release of proceeds and the creation of the new accounts a substitution of collateral so that the interest of Rose City in the new accounts cannot be preferential under Section 60 of the Bankruptcy Act?

2. If the transfer of such accounts is deemed to have taken place during the four-month period, are the accounts which arise in the ordinary course of the business of the debtor taken for new value and not as security for an antecedent debt as provided in Section 9-108 of the Code (O.R.S. § 79.1080)? [1]

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[1] Code section numbers conform to sections of the Oregon Revised Statutes if the dash is changed to a decimal point and the number is expanded by adding the digit 7 at the beginning and the digit 0 at the end.

3. Where almost a year before bankruptcy of the debtor (*a*) Rose City makes a loan to the debtor, (*b*) the debtor grants Rose City a security interest in its then existing and future accounts receivable, and (*c*) a financing statement is publicly filed under the Uniform Commercial Code, does the transfer of those accounts receivable which are generated by the debtor during the four-month period prior to its bankruptcy take place before the four-month period for the purposes of applying Section 60 of the Bankruptcy Act?

Argument.

I. The Effect of the Merger of Portland Newspaper Publishing Co., Inc., and Portland Reporter Publishing Co., Inc.

The Permanent Editorial Board's concern with this case and its importance to secured financing throughout the country has centered on issues raised by the interaction of the Uniform Commercial Code and Section 60 of the Bankruptcy Act, 11 U.S.C. § 96, when an obligation is secured by a changing pool of collateral. These issues were central to the decisions of the District Court and of the Referee, and were considered at length in both forums. Before getting to them, however, we feel obliged to comment on new and quite different issues which are raised in the Trustee's Brief for the first time and without the benefit of any consideration below.

The Trustee now argues that the merger of the Reporter and the Bankrupt invalidated Rose City's security interest in the accounts receivable which arose after the merger, and that, even if valid, such interest was unperfected because no new financing statement was filed show-

ing "Portland Newspaper Publishing Co., Inc.," as the secured party and signed in that name (Trustee's Brief, 17-20).

The argument as to validity has two parts, both of which would seem to be disposed of by the merger agreement (Ex. 19). The first part of the argument is that with respect to those accounts which arose after the merger, the requirements of Article 9's Statute of Frauds, set out in Section 9-203(1) of the Code (O.R.S. § 79.2030(1)), were not met, since the security agreement between the Reporter and Rose City was not specifically re-executed in the name of Portland Newspaper Publishing Co., Inc. Comment 5 to Section 9-203 states that more harm than good would result from allowing creditors to establish a secured status by parol evidence after they have neglected the simple formality of obtaining a signed writing. American Law Institute Uniform Commercial Code, 1962 Official Text with Comments, 641-642. The merger agreement between the Reporter and the Bankrupt was a signed writing, and, in view of its provisions that the Bankrupt would succeed to the Reporter's rights, privileges and immunities, and would be subject to the Reporter's liabilities and duties, the Bankrupt's signature thereon authenticated the security agreement as much as if it had been written on the security agreement itself. See Section 1-201(39) (O.R.S. § 71-2010(39)).

The second part of the argument is that the description of the collateral in the security agreement was not broad enough to cover accounts generated by the surviving corporation. This involves the effect on an existing financing arrangement of a change or modification of the make-up of one of the parties to the arrangement. Such a change can occur in a variety of ways. A new partner joins an

existing partnership. An old partner retires. A small corporation merges or consolidates with a large corporation. A corporation makes extensive modifications of its articles of incorporation, including substantial changes in control, classes of stock, and, perhaps, its purposes.

Article 9 of the Code leaves the law regarding the effect of modifications or changes of make-up to general law and to the courts. The results, of course, depend both upon the nature of the problem and upon the nature of the change or modification. Here the problem is to determine what property is covered by the after-acquired-property clause in the security agreement signed originally by the Reporter and adopted by the Bankrupt.

One example of a change of make-up might involve a large corporation in the construction business which merges with a small architectural firm. In such a case a security agreement covering the accounts receivable of the architectural firm would probably not pick up the accounts receivable arising, after the merger, out of the construction side of the business. On the other hand, the Board assumes that, under general merger principles, a security agreement covering construction machinery owned and to be acquired in the future by the construction company would be construed to survive the merger and cover any such equipment acquired thereafter. Any other holding would substantially complicate the many situations where slight changes of make-up occur and would place an additional burden on secured parties which, even if shouldered, would result in no particular benefit to the other creditors.

The application of the after-acquired-property clause in the security agreement before this Court creates no ambiguity, since the purpose of the merger of the Reporter and the Bankrupt was merely to carry out a refinancing and change of control of the publishing company. The

accounts receivable generated after the merger were the same accounts as would have been generated if the refinancing had been accomplished without a merger. There would have been a different problem if there had been a merger of two operating newspapers into a single newspaper. But this was not the case. Prior to the merger, Portland Reporter Publishing Co., Inc., was publishing and selling the Portland Reporter. After the merger, Portland Newspaper Publishing Co., Inc., was publishing and selling the Portland Reporter.

The issue raised by the Trustee with respect to the financing statement is an important one and could be decided in a way which would seriously undercut the objectives of the draftsmen of the Uniform Commercial Code to simplify and rationalize security transactions. The financing statement issue has two parts, which should first be considered separately. One is the change of name, and the other is the change of make-up.

Although Part 4 of Article 9 of the Code contains no specific provisions on the subject, it contemplates that a financing statement which is properly filed continues effective even though one of the parties thereto changes its name. This conclusion is supported by a literal reading of Section 9-403(2) (O.R.S. § 79.4030(2)), which provides:

> "A filed financing statement which states a maturity date of the obligation secured of five years or less is effective until such maturity date and thereafter for a period of sixty days. Any other filed financing statement is effective for a period of five years from the date of filing.

Further support for this conclusion is found in Section 9-402(2) (O.R.S. § 79.4020(2)) and in the alternative form of Section 9-401(3) offered in the official draft, but not

adopted by the Oregon Legislature (American Law Institute Uniform Commercial Code, 1962 Official Text with Comments, 699). Both of these provisions deal with situations where some action of the debtor, such as changing his residence, moving the collateral or selling the collateral, will terminate the perfected status of the secured party's security interest in the collateral. Both of these provisions recognize that, under these circumstances, it may be impossible for the secured party to obtain the debtor's signature on the new financing statement required to maintain perfection, and both therefore permit the secured party to file a financing statement signed only by the secured party. If the debtor could similarly jeopardize the perfection by changing his or its name, the Code would have given the secured party the same protection.

We come to a similar conclusion concerning the effect which the change of make-up would have had on the financing statement if there had been no change of name. The financing statement would continue to be effective. As between the parties, the merger agreement and the merger statutes would seem to eliminate any requirement of a new financing statement. From the point of view of third parties examining the records, the execution of a new financing statement by a successor corporation of the same name and address would seem to have no effect except to start the five-year period running again.

In the case before this Court, involving, as it does, only a slight change in the name and a modification only of the control and financing of what is essentially the same business, we see no reason why the result should be any different. If the Court should disagree, however, and decide to apply a more stringent test, it should look to the rule set out in Section 9-402(5) (O.R.S. § 79.4020(5)) with regard to errors or variations in the original financing state-

ment. It is there provided that a financing statement is effective if it substantially complies with the requirements of Section 9-402, even though it contains minor errors which are not seriously misleading.

Comment 5 to Section 9-402 states that the subsection is designed to reverse *General Motors Acceptance Corporation* v. *Haley,* 329 Mass. 559, 109 N.E. 2d 143 (1952), in which a statement of trust receipt financing was held invalid when made in the name of "E. R. Millen Company" when the Trustee was actually "E. R. Millen Co., Inc." (American Law Institute Uniform Commercial Code, 1962 Official Text with Comments, 704). The Court of Appeals was clearly influenced by this Comment when in *In re Excel Stores, Inc.,* 341 F. 2d 961 (2d Cir. 1965), it held that a financing statement showing the debtor as "Excel Department Stores" was not seriously misleading, although the debtor's correct name was "Excel Stores, Inc."

While the Board has not examined, the complete record in this case on the issue of whether or not the slight change of name would be regarded as seriously misleading, it notes again that the Reporter and the Bankrupt were carrying on essentially the same business, were both publishing the Portland Reporter and were apparently sufficiently identical in both name and business that nobody thought to raise these issues either before Judge Solomon or before the Referee. If this Court decides to consider the issues now raised by the Trustee, it would seem that there is ample basis for rejecting the Trustee's contentions.

II. The General Rationale of the Uniform Commercial Code in Relation to the Bankruptcy Act.

Both secured and unsecured credit are essential parts of the American economy. In a few situations and at certain

times their interests conflict. In infinitely more situations and times their functions are complementary or parallel, with no conflict but rather mutual benefit to each other and to those extending or utilizing each type of credit.

The present case involves a dispute between secured and general creditors. It also involves a dispute between what might be called "financing creditors" and "merchant creditors." The first group is made up primarily of banks, finance companies, life-insurance companies and other institutional lenders. The second group is made up primarily of creditors extending credit by the sale of goods and services, frequently called "trade creditors."

Suppliers of goods and services or merchant creditors (including wage claimants) received their full share of the money made available to business entities through financing credit because, obviously, financing credit used by the average business entity will, in turn, be used to make payments to its suppliers of goods and labor as well as for other purposes.[2]

Long before the drafting, promulgation and enactment of the Uniform Commercial Code it was possible for a debtor to give and a creditor to receive security in personal property in substantially all of the ways that are available under Article 9 of the Code. However, where these various security devices all developed at different times in history; were created to meet different needs; were evidenced by different forms of agreement; and public notice of them was given in different ways—there were many problems and many technical and formal requirements, turning not on the function of the financing but on its form, with resultant confusion and traps for the unwary. The net

[2] In the fourth quarter of 1965 manufacturing corporations were furnished 33 billion dollars of merchant credit and 61 billion dollars of financing credit. See FTC-SEC, Quarterly Financial Report for Manufacturing Corporations, Fourth Quarter, 1965, at 34.

result of this was that secured credit was needlessly complex in execution and costly to the borrower beyond any requirement of fairness to the general or merchant creditors.

The issue for the draftsmen of the Uniform Commercial Code, therefore, became one of simplification and cheapening of this type of credit without injury to the legitimate interests of unsecured creditors. These interests rest primarily on the elimination of secrecy and on the non-monopolization of a debtor's assets by a secured lender. The provisions of Article 9 of the Code require notice of the existence of a security interest to be given either by possession or by filing, with a few exceptions not relevant here. As a result, general creditors or merchant creditors can ascertain at any time whether or not a prospective debtor has given security to any other person. In many cases the general creditor will be glad this security has been given because of the increased financial strength implied by it. But, whether he is or is not pleased, if the general creditor elects to extend credit, he does so with his eyes open.

The Code is entirely fair in provisions as to who may obtain security. Under the Uniform Trust Receipts Act and under Factors Lien Acts this type of security was available only to financing creditors. But under the Code security of exactly the same type may be obtained by merchant creditors, and these creditors, if they elect to follow the simple rules of the Code as to purchase-money security interests, may even obtain priority over a financing lender. Other built-in deterrents to monopolization of a debtor's assets include the provisions of Section 9-208 (O.R.S. § 79.2080) requiring a secured party to confirm or disclose the amount of the debt and collateral, thus permitting the debtor or a competing financer to pay off the debt and ef-

fect a release of the collateral; the possibility of subordination (as the Bankrupt obtained from the general financer, Rose City, in favor of Davis in this case), Section 9-316 (O.R.S. § 79.3160); and the simple power of a debtor to limit the security of any secured party. Actual experience in operations under the Code clearly establishes that earlier fears of monopolization of assets by a single secured financer simply have not been substantiated.

In the type of financing represented by this case, the Code requires that notice of the financing be given to all the world, as was done, not only by Rose City, but also by Mr. Davis and Mr. DuBay. Further, Section 9-108 (O.R.S. § 79.1080), in conferring new value as distinguished from antecedent-debt status on after-acquired property collateral, is careful to limit this result to cases where the debtor acquires his rights in the ordinary course of business.

The policy of the Uniform Commercial Code toward the simplification of secured credit is entirely consistent and not in conflict with the basic principles of Section 60 of the Bankruptcy Act. Section 60 is pointed primarily at the potential of one creditor acquiring shortly before bankruptcy by aggressive tactics more than his fair share of an insolvent estate. It is also aimed at secret liens of a type for which local law requires some form of public notice. To achieve these objectives it establishes an arbitrary four-month period prior to bankruptcy during which certain acts by any creditor of the Bankrupt, whether secured or unsecured, which acts are done with knowledge or reason to know of the debtor's insolvency and which acts improve the creditor's position with respect to other creditors, can be avoided by the Trustee in Bankruptcy. Congress has established an elaborate set of rules for application of these objectives which are themselves quite complicated and each of which has its own growing body of law. These rules are designed to determine whether an act oc-

curs prior to the four-month period or during the four-month period, and, when it is found to occur during the four-month period, to determine whether the act is of the aggressive nature which should be prohibited.

In the application of these technical rules, some of which were written without anticipation of modern security law, sight should not be lost of the underlying objectives.[3] On the particular facts of this case, no aspect of Rose City's security interest in the accounts receivable conflicts with those underlying objectives. It is the purpose of this Brief to show that this security interest is entirely consistent not only with the objectives but also with the more detailed rules of Section 60.

III. Rose City's Security Interest in the Receivables Outstanding on September 28 was Not Preferential, since Most of the September 28 Receivables were Substituted for Those Outstanding at the Beginning of the Four-Month Period.

A. The Substitution-of-Collateral Doctrine.

The burden of proving all six elements of a preference is upon the Trustee. *Keenan Pipe & Supply Co.* v. *Shields,* 241 F. 2d 486 (9th Cir. 1956). *Barry* v. *Crancer,* 192 F. 2d 939 (8th Cir. 1951). See *Miller* v. *Fisk Tire Co.,* 11 F. 2d 301, 304 (D. Minn. 1926), and *Pasadena Investment Co.* v. *Pasadena Air Products, Inc.,* 234 F. Supp. 128, 134 (S.D. Cal. 1964). These elements are set out in paragraph (1) of Section 60a as follows:

> "A preference is a transfer, as defined in this Act, of any of the property of a debtor to or for the benefit

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[3] Compare *Bank of Marin* v. *England,* 385 U.S. 99 (1966), in which the Supreme Court declined to apply Section 70d of the Bankruptcy Act literally.

of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition initiating a proceeding under this Act, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class."

The foregoing language is drawn in substance from Section 60 of the Act of 1898, 30 Stat. 562. It was early held under Section 60 that a transfer made by an insolvent debtor within four months of the debtor's bankruptcy is not a preference where the transfer is made for new and substantially contemporaneous consideration. *Dean* v. *Davis,* 242 U.S. 438 (1917). Both the rationale for this holding and the many cases which support it are set out in 3 Collier on Bankruptcy, 846-888 (14th ed. 1967). The pages cited discuss the antecedent-debt requirement, which is categorized as the third element of a preference, and assert that Section 60 avoids only those transfers which result in a depletion or diminution of the Bankrupt's estate available for creditors.

The diminution rule articulated, for example, in *Bachner* v. *Robinson,* 107 F. 2d 513, 514 (2d Cir. 1939), and *In re Loring,* 30 F. Supp. 758, 759 (D. Mass. 1939), can be justified under paragraph (1) on the theories that, if a transfer does not deplete the estate available for creditors, either it is made for contemporary consideration and is therefore not made "for or on account of an antecedent debt" or it does not "enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class." [4]

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[4] Two provisions of Section 60 covering special situations support the general principle of the diminution rule. One is the

A corollary to the diminution rule is the rule, also early recognized in bankruptcy law, permitting the exchange, substitution or renewal of security. In *Sawyer* v. *Turpin,* 91 U.S. 114, 120-121 (1875), for example, the Supreme Court said:

> "It is too well settled to require discussion, that an exchange of securities within the four months is not a fraudulent preference within the meaning of the Bankruptcy Law, even when the creditor and the debtor know that the latter is insolvent, if the security given up is a valid one when the exchange is made, and if it be undoubtedly of equal value with the security substituted for it."

B. There is No Preference where New Accounts are Substituted for Proceeds of Collected Accounts Released to the Debtor.

The foregoing principles were applied to accounts-receivable financing in *In re Pusey, Maynes, Breish Co.,* 122 F. 2d 606 (3d Cir. 1941), affirming 37 F. Supp. 316 (E.D. Pa. 1941). In that case Judge Goodrich, for a unanimous court, upheld the security interest of the Philadelphia National Bank in accounts receivable assigned to it during the four months prior to bankruptcy as security for indebtedness of $20,000 incurred prior to the four-month period.

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language in paragraph (8) of subdivision *a* covering transfers where neither filing, recording nor delivery is required for perfection against lien creditors under local law, which provides that a transfer for new and contemporaneous consideration or for a future loan actually made is deemed to take place on the date of the transfer. The other is subdivision *c* of Section 60, which provides that a creditor who receives a preferential transfer and later makes an *unsecured* loan to the Bankrupt may set off the unpaid portion of the loan against the amount receivable by the Trustee on account of the preference.

Under the arrangement between the debtor and the bank the accounts receivable which were from time to time assigned to the bank during the year prior to the bankruptcy were collected by the debtor and deposited in a special account with the bank from which the debtor could make withdrawals only with the consent of the bank. Proceeds of cash sales made by the debtor were also deposited in this account. The agreement provided that, if the debtor had new accounts which were satisfactory to the bank as security, it could offer them to the bank in substitution for the release of the moneys on deposit. The face amount of the accounts receivable at the inception of the arrangement was $21,995.25. It was agreed that from the inception of the arrangement it was the "practice" of the bank to require that the net amount of the assigned accounts receivable plus the balance of the special account should at all times aggregate $25,000 before permitting any withdrawals by the debtor from the account. Four months before bankruptcy the aggregate was $24,640.10, and on the date of bankruptcy it was $25,368.41, of which $4,854.01 was on deposit in the special account and $20,514.40 was the face amount of assigned accounts. Of these accounts all but $427.63 worth had been assigned to the bank during the four months immediately preceding the filing of the bankruptcy petition.

The Referee in Bankruptcy concluded that the substitution of collateral, not being made simultaneously with and in equal amounts to the release of cash by the bank to the debtor from the special account, constituted a fraud on creditors within the rule of *Benedict* v. *Ratner,* 268 U.S. 353 (1925). Judge Goodrich found that the law of Pennsylvania included the rule of *Benedict* v. *Ratner* and that therefore, under Pennsylvania law, an assignment of accounts receivable would be deemed fraudulent as to the

rights of creditors if the assignor had control over the accounts to the extent that he was free to use the proceeds of the accounts for his own purposes. He held, however, that the arrangement between the bank and the debtor did not violate the rule.

More important, however, he held that there was no basis for invalidating the bank's security interest in the accounts under Section 60. Counsel for the Trustee cited cases for the proposition that the substitution-of-collateral doctrine could not be applied unless the transfer of the new collateral and withdrawal of the old collateral took place simultaneously. As the Court pointed out, however, all of the cases cited involved "substitution" where the old item of collateral was released a substantial period of time *before* the new collateral was transferred. Judge Goodrich indicated that, once the new collateral had been acquired, it was immaterial whether the old collateral was released simultaneously or subsequently. He reasoned that to hold otherwise would invalidate mortgages for future advances.

Counsel for the Trustee also argued that, to the extent the new security had a higher value than the old security, the bank's security interest was preferential. While conceding that this might be the correct rule, Judge Goodrich held that the Court did not have possession of sufficient facts to determine that there was such a difference in value, and that it therefore had no basis for invalidating any part of the assigned assets in the bank's hands.

C. Rose City's Security Interest Meets the Most Stringent Requirements of the Substitution-of-Collateral Doctrine.

Relying to a considerable extent on an early Circuit Court of Appeals case, *Wolfe* v. *Bank of Anderson,* 238 F. 343 (4th Cir. 1916), the Trustee argues that two rules must be strictly applied in determining whether transfers dur-

ing the four-month period are to be considered substitutions of collateral. The first is that the new collateral must be transferred to the secured party either prior to or contemporaneously with the release of the old collateral. The second is that, if the new collateral is of greater value than the collateral which is released, a voidable preference for the difference in value may result (see Trustee's Brief, 41).

From these two rules it is possible to derive a third rule as follows:

> Where a changing pool of collateral secures fixed indebtedness during the four-month period prior to bankruptcy, the collateral in which the secured party has a security interest on the date of bankruptcy is subject to attack on grounds of preference to the extent that its value on the date of bankruptcy exceeds the lowest value of the collateral pool during the four months prior to the bankruptcy of the debtor.

The derivation of the third rule from the two rules advocated by the Trustee is discussed at greater length in the Appendix to this Brief. For convenience, we will refer to it as the *strict test,* and will later argue in this Brief that there are more suitable tests for use in determining whether or not a security interest in a changing pool of collateral meets both the objectives and the technical requirements of Section 60.

Based on the facts and assumptions stated at the beginning of this Brief, however, there can be no question that Rose City's security interest in the accounts collected by the Trustee meets the *strict test.* The minimum balance of *billed* accounts from the beginning of the four-month period until September 28, the date on which Rose City began to collect the accounts through its Trustee, was

$129,000, an amount which was more than twice the claim of Rose City. During that same period collections released to the Bankrupt totalled $397,860.24, while new billings totalled $395,085.87.[5]

On these facts and figures it could hardly be clearer that the Trustee has failed to sustain his burden of proving that the Bankrupt's estate was diminished during the four-month period.

D. The Rule of Benedict v. Ratner is a Matter of State, Not Federal, Law.

The case before this Court differs from the *Pusey* case in two respects, neither of which changes the result. The first difference is the fact that it was unnecessary for the Bankrupt to make new assignments of its accounts each time new accounts were generated, since under Sections 9-204, 9-302 and 9-402 of the Uniform Commercial Code

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[5] See the chart on page 41 of the Appendix. More than $55,000 was collected from the $141,000 of billed accounts outstanding on September 28, since $126,829 was collected by the representative of the secured creditors and $71,061.90 was billed after September 28, all of which was probably not collected. It is therefore unnecessary at this point in the argument to consider Rose City's interest in the accounts billed after that date. For a discussion of such interest see Part IV, A, pp. 26-27.

The Trustee argues that, even if the transfers to Davis and DuBay are invalid, it is not clear that "those accounts" were assigned to Rose City (Trustee's Brief, 46). This argument has no validity as to Mr. Davis, since the security agreement contains no limitation whatsoever with respect to accounts purportedly assigned to him. The subordination agreement with Mr. Davis subordinates Rose City's interest only to those accounts which are in fact acquired by Mr. Davis (Ex. 15). Rose City's security agreement does except from its coverage accounts "heretofore assigned" to Mr. DuBay (Ex. 17). If the Court holds that none of the accounts in question were assigned to DuBay, however, then none of them fall within the exception.

(O.R.S. §§ 79.2040, 79.3020 and 79.4020) an assignment of present and future accounts accompanied by the proper filing of a financing statement was all that was required to obtain a valid and perfected lien in the new accounts as they arose. This is a matter upon which state law supplies the conclusive answer. See *Mason* v. *Citizens' Nat. Trust & Savings Bank,* 71 F. 2d 246, 248 (9th Cir. 1934), and 3 Collier on Bankruptcy, 957-961 (14th ed. 1967).

The second difference is the fact that, although the debtor collected the accounts in this case and in the *Pusey* case, and although in both cases the secured party had the right to prevent the debtor from utilizing the proceeds for its own purposes, in the *Pusey* case the debtor was not allowed to utilize them until they had first been deposited in a special account, a procedure required under the law of Pennsylvania by the rule of *Benedict* v. *Ratner.* In the case before this Court the debtor was permitted to use the proceeds until Rose City asserted its right to them, which it did assert at two different times.[6]

Under Section 9-205 of the Code (O.R.S. § 79.2050) the dominion rule of *Benedict* v. *Ratner* is no longer part of the law of Oregon. In enunciating the rule in the case for which it is named, Justice Brandeis made it clear that he was talking about state rather than federal law (268 U.S. 353, 360

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[6] The failure to check "Proceeds" in the financing statement filed by Rose City is irrelevant under the facts of this case, since the proceeds at issue were collected by a representative of the secured creditors and never came into the possession of the debtor. Undr Section 9-306(3) of the Code (O.R.S. § 79.3060(3)), even though proceeds are not claimed in the financing statement, the security interest in them is continuously perfected until ten days after "receipt of the proceeds by the debtor." If proceeds had been claimed by Rose City in the financing statement, it would have had a claim against any identifiable proceeds in the possession of the Bankrupt, a claim which probably would have been of little value.

(1925)), and in *Petition of Post,* 17 F. 2d 555 (1st Cir. 1927), cert. den. 275 U.S. 527 (1927), it has since been held that the rule is not one of federal law. The Referee's opinion in the case before the Court indicates otherwise by suggesting that a preference might have been avoided by having the proceeds flow through a cash-collateral account (R. 36).

The Trustee's Brief seems to distinguish the case before this Court from *Pusey* solely on the basis that Rose City failed to police the collections by the debtor. The distinction, however, seems to be an evidentiary one. He says on page 44 of his Brief:

> "A secured party who fails to police his collateral probably will be unable to demonstrate that the releases of collateral occurred at the requisite points in time."

This assertion, of course, overlooks the fact that the burden of proving all elements of a preference is on the Trustee (see cases cited on page 15 hereof). In fact, the Trustee in *Pusey* made an analogous argument when he claimed that the value of the security had gone up during the four-month period. The Court, however, said that there was not sufficient evidence to determine the question, despite the fact that the dollar total of the cash-collateral account and the face amount of the uncollected accounts was somewhat higher on the date of bankruptcy than it was at the beginning of the four-month period. A similar argument advanced by the Trustee in *Rosenberg* v. *Rudnick,* 262 F. Supp. 635, 640 (D. Mass. 1967), was rejected on the same basis.

Regardless of the burden of proof, it can well be asked whether the policing of the collateral in *Pusey* would, if the Court had adopted the *strict test* advocated by the Trustee, have made it any easier to apply that test. Its

application would have required determining the lowest value of the collateral during the four-month period. It seems perfectly obvious that the determination of the value of the assigned accounts at any moment in time would have been equally difficult whether proceeds of the accounts later flowed through a cash-collateral account or through the debtor's regular bank account.

The Trustee stresses the fact that Exhibit 39 fails to show account balances at various times during any given day. This objection itself indicates the absurdity of the *strict test*. The Trustee also urges that Exhibit 39 fails to reflect the real value of the collateral as distinguished from its book value (Trustee's Brief, 46, 47). It should be pointed out that neither of these objections is affected in any way by, or has anything to do with, whether the secured party requires that the proceeds of the accounts be run through a cash-collateral account. Both of them are equally applicable to the fact situation in *Pusey* and therefore are no basis for distinguishing *Pusey.*

With the development and general adoption of modern accounting principles and methods which enable simpler and yet reliable procedures for checking collateral and with the repeal of the rule of *Benedict* v. *Ratner,* many lenders making term loans secured by a changing pool of collateral have, in appropriate situations, dispensed with the expense and trouble of requiring that proceeds of the pool flow to the lender and back to the borrower through a loan account or a cash-collateral account. In this type of loan, where a financing statement has been filed giving public notice of the lender's security interest in the collateral, pouring the funds through a special account instead of releasing them directly to the borrower gives no additional protection to the unsecured creditor. In fact, by lengthening the pipeline through which the proceeds flow, it may increase the percentage of the debtor's assets subject to the security

interest of the secured lender, and, by substantially increasing the cost of the secured credit, may make the borrower's financial situation more precarious, thus having an adverse effect on the position of the unsecured creditor.

By enacting Section 9-205 of the Code and repealing or confirming the inapplicability of the rule of *Benedict* v. *Ratner,* the Legislatures of forty-nine states and the United States Congress, for the District of Columbia, are saying that, if public notice of the existence of a security interest is given by the filing procedures of the Uniform Commercial Code, exercise of dominion under the principles of *Benedict* v. *Ratner* is no longer important. There is nothing in the policy or language of Section 60 which frustrates this repeal. In the words of the District Court (R. 99), "Good business practice should be good business law."

IV. Rose City's Security Interest in the Receivables Outstanding on September 28 was Not Preferential since All the Receivables Subject to the Security Interest Arose in the Ordinary Course of the Debtor's Business.

A. Precise Application of a "Strict" Substitution-of-Collateral Rule is Impractical.

This Brief could stop here except for the fact that the Court might decide to uphold the prior claims of Messrs. DuBay and Davis. In that event the question of whether the value of the collateral in which Rose City had its security interest on the date of bankruptcy exceeded the lowest value of the collateral in which Rose City had an interest during the four-month period prior to bankruptcy becomes a much closer one. Here again, however, it is perfectly clear that the Trustee has failed to sustain the burden of proof.

In order to have sustained that burden, the Trustee, if he is to insist on the *strict test,* should have offered evidence to prove that at some point during the four-month period the value of Rose City's collateral dropped below the amount of its claim. The evidence offered to establish the value of the collateral at such point in time (1) should show the value of the then unbilled accounts, (2) should show the true value as opposed to the book value of the accounts outstanding at the time, and (3) should include the value of accounts arising subsequent to the date of valuation out of any contract rights in which Rose City then had a perfected security interest.

The first of these requirements is based on the fact that on any particular day the collateral included not only the billed accounts, which would be reflected in the daily balances appearing in Exhibit 39, but also the unbilled accounts. Section 9-106 of the Code (O.R.S. § 79.1060) provides that an "account" is a right to payment for goods sold or services rendered. There is no requirement that it be billed. The official comment to this Section states that the right to payment is "a right earned by performance, *whether or not due and payable*" (American Law Institute Uniform Commercial Code, 1962 Official Text with Comments, 627). (Italics supplied.)

The adjustment in the total value of the collateral made on account of unbilled accounts would be particularly significant in the case of the monthly circulation accounts earned by delivery of newspapers during the month, half of which would be earned by the fifteenth of the month, even though they were not billed until the end of the month. The adjustments for unbilled accounts would tend to raise the overall value of the accounts, and would presumably smooth down the fluctuations in that value resulting from monthly billings.

For example, on June 27, the date on which outstanding billings dropped to their low point of $129,000, total outstanding uncollected accounts subject to Rose City's security interest were closer to $180,000, since 27/30 of the approximately $50,000 of circulation accounts which were billed at the end of June had been earned. A similar adjustment should be made as of September 28, the date on which the secured creditors appointed a trustee to collect the accounts. Since the Bankrupt ceased doing business two days later, all but a small portion of the approximately $71,000 of accounts billed after September 28 were earned and subject to Rose City's security interest on that date.

The second requirement, referred to above and suggested on pages 46 and 47 of the Trustee's Brief, raises questions as to how the real value of the accounts is to be determined. Is it market value, forced-sale value, or the amount ultimately collected thereon regardless of the circumstances of such collection? Since the Trustee has failed to introduce any evidence on the valuation question, it is unnecessary to answer these questions other than to assert that, where an account increases in value while it is in the collateral pool—which might be the case if an insolvent account debtor becomes solvent and is able to pay in full—it should be valued at its full value throughout the entire period that it is in the collateral pool. Compare *In re Hygrade Envelope Corp.*, 393 F. 2d 60 (2d Cir. 1968). This assertion is perfectly consistent with what one writer has referred to as the "fat pig" mortgage, where there is no preference under Section 60 despite the fact that the pig grows heavier and more valuable during the four-month period. See Hogan, "Games Lawyers Play with the Bankruptcy Preference Challenge to Accounts and Inventory Financing," 53 Cornell L.R. 553, 558 (April, 1968).

The third requirement is suggested by the fact that Rose City claimed as its collateral not only accounts of the Bank-

rupt but also its contract rights. Under Section 9-106 of the Code (O.R.S. § 79.1060) both accounts and contract rights are rights to the payment of money. The essence of the distinction between them is that an account is a right to payment that has been earned and a contract right is a right to payment that has not yet been earned. Contract rights would include the Bankrupt's unearned rights to payment under all its circulation contracts and under whatever advertising contracts it may have had.

The effect of an assignment of contract rights on the preference problem was considered in the important case of *Rockmore* v. *Lehman,* 129 F. 2d 892 (2d Cir. 1942), cert. den. 317 U.S. 700 (1943), reversing 128 F. 2d 564 (2d Cir. 1942). In that case, which was decided after the adoption of the 1938 amendment to the Bankruptcy Act, the debtor had entered into contracts with Calvert Distillers Corporation under which it was to furnish and maintain advertising signs for Calvert. The contracts were cancellable by Calvert upon due notice. The debtor assigned the contracts to one Abrams as security for loans which enabled it to build the signs. Proceeds of the contracts were paid to Abrams over roughly a two-year period. Thereafter creditors of the debtor filed a petition for reorganization under Chapter 10 of the Bankruptcy Act, and a trustee was appointed. Calvert deposited with the Court checks representing amounts due for services rendered during the three months prior to the Chapter 10 proceeding. The Court, speaking through Judge Augustus Hand, held that, in determining the application of Section 60 of the Bankruptcy Act, the date of the assignment of the contracts rather than the date on which the accounts were earned governed the imposition of the lien on any accounts due from Calvert under the contracts.

On this issue it looked to state law and found that, under the law of New York, once the contract had been assigned,

the rights of the assignee to the present and future accounts thereunder were good against bona-fide purchasers within the meaning of the test then established in Section 60. The same result would have occurred in the case had New York then had the Uniform Commercial Code. Under Section 9-306 (O.R.S. § 79.3060) proceeds are defined to include "the account arising when the right to payment is earned under a contract right." The Section goes on to provide that a security interest in proceeds "is a continuously perfected security interest if the interest in the original collateral was perfected." Comment 2(b) to the Section indicates that the reference to the continuity of the security interest is to "make clear that the four month period for calculating a voidable preference in bankruptcy begins with the date of the secured party's obtaining the security interest in the original collateral and not with the date of his obtaining control of the proceeds" (American Law Institute Uniform Commercial Code, 1962 Official Text with Comments, 670).

In the case before this Court it should be noted that Rose City's financing statement described the collateral as "accounts receivable." Since the Trustee introduced no evidence on the value question, the Court will not have to decide whether this description is broad enough to cover the assignment of the unearned rights to payment under Bankrupt's circulation and advertising contracts. If it is broad enough, accounts arising after June 15, 1964 (the beginning of the four-month period prior to bankruptcy), out of contracts which were outstanding on June 15, 1964, are to be treated as having been transferred before June 15, 1964. This requires that they be treated in the same manner as any other item of collateral which increases in value during the four-month period. As previously suggested, where collateral increases in value during the four-

month period, it should be treated throughout the period at its ultimate value.

In light of the difficulties of accurately applying the *strict test* in many situations involving a collateral pool, the refusal of the Court in *In re Pusey, Maynes, Breish Co., supra,* to decide whether the *strict test* is required seems wise. At least three other courts seem to have adopted different tests.

In *Wolf* v. *Aero Factors Corporation,* 221 F. 2d 291 (2d Cir. 1955), the Court, in upholding cross-collateral provisions in a financing arrangement entered into prior to the four-month period which involved a series of advances made against assignments of accounts during the four-month period, found no preference because each assignment was made "for a fair and present consideration." In some cases accounts assigned brought more than the advance made against them, and in others they brought less. The Court permitted the excess in the one case to be used to make up the deficiency in the other without any effort to apply strict substitution of collateral rules. It rejected the Trustee's argument that each of the transactions should be looked at separately.

In *Matthews* v. *James Talcott, Inc.,* 345 F. 2d 374 (7th Cir. 1965), cert. den. 382 U.S. 837 (1965), the secured party was financing both inventory and receivables under separate arrangements entered into prior to the four-month period. The inventory financing was secured pursuant to the Indiana Factors Lien Act, which required designations of the inventory. Citing cross-collateral provisions in the factor's lien agreement, the Court held that four designations of inventory made during the four-month period secured receivables loans made during the same period where the receivables turned out to be worthless. It so held even though one of the designations was made on the day fol-

lowing the last receivables loan. Here, also, the Court made no effort to apply strict substitution of collateral rules.

In re Hygrade Envelope Corp., 393 F. 2d 60 (2d Cir. 1968), involved a security interest in inventory and receivables of the Bankrupt arising under the New York Factors' Lien Act, a law under which the factor's interest in any account was inferior to the lien of an attaching creditor until the factor either notified the account debtor of his interest in the account or until he obtained an additional assignment of the account from the borrower. The Court sought to determine whether new inventory and new accounts of the borrower arising between November 26 and the following January 24, the date of bankruptcy, could secure indebtedness of the borrower outstanding on November 26 without being preferential. It gave as an example a sale by the borrower on December 10 of $10,000 worth of pre-November 26 inventory, and pointed out that, under *Pusey,* new inventory or receivables to which the factor's lien attached on or before December 10 could be substituted as collateral in place of the inventory sold. It pointed out, however, that under the strict substitution rules of the early cases the account receivable arising from the sale of the inventory often could not, under the New York statute, be substituted for the inventory, since the perfection by notice to the account debtor or by a new assignment might not occur until some period after the inventory had been sold, thus violating the first of the two substitution-of-collateral rules advocated by the Trustee.

The Court suggested that this rule was really based on the rule of *Benedict* v. *Ratner,* which under New York law did not apply to factors' liens. It therefore held that there would be no preference as to *any* post-November 26 receivable or inventory which merely replaced similar security

held on that date. This is not unlike Judge Solomon's decision below (R. 100). In effect, this approach compares values at the beginning and end of the period and ignores fluctuations in between. Compare *Pasadena Investment Co.* v. *Pasadena Air Products, Inc.,* 234 F. Supp. 128 (S.D. Cal. 1964).

The Courts were dealing in *Wolf* and *Matthews* with assignments of accounts and designations of inventory which were executed and delivered during the four-month period, and in *Hygrade* with assigned accounts where notice or an additional assignment was required during the period. All three cases, however, involved continuing financing arrangements which were entered into before the beginning of the four-month period, and all three involved collateral arising in the ordinary course of business. To this extent they may be regarded as forerunners of the rule in Section 9-108 of the Code (O.R.S. § 79.1080).

B. Section 60 is Aimed at the Creditor who Seeks to Strengthen his Position when Trouble Seems Imminent.

Prior to the 1938 amendments to the Bankruptcy Act courts had held that a number of types of security interests which were created four months prior to the bankruptcy were not preferential where the defects (including lack of public notice) were remedied by some action taken before bankruptcy, even though such action was taken within the four-month period. The most famous of these cases is *Sexton* v. *Kessler,* 225 U.S. 90 (1912), in which the debtor agreed with the secured party to hold specified securities as security for its indebtedness to the secured party, but did not deliver the securities to the secured party until four years later, just two weeks before the debtor's bankruptcy. The Supreme Court held that the secured party's

security interest in the securities was not preferential, since the transfer of the securities took place four years before the delivery; the theory being that the agreement to hold the securities for the secured party created an equitable lien.

The 1938 amendment to Section 60, which provided that the transfer did not take effect until the transferee's interest was good against a bona-fide purchaser, was aimed directly at reversing this result; the theory of this solution being that equitable liens were not good against bona-fide purchasers. Unfortunately, this vulnerability to the rights of bona-fide purchasers was also shared by certain legal security interests such as the security interest in inventory, which was always subject to defeat by a buyer in the ordinary course of business, and the security interest in accounts receivable, which in some states under certain circumstances was subject to defeat by subsequent assignees.

The 1950 amendments were designed to remedy this defect. Their basic purpose was "to retain unimpaired the basic object of the 1938 amendment, which eliminated the relation-back doctrine of *Sexton* v. *Kessler* . . ." H.R. Rep. No. 1293, 81st Cong., 1st Sess. 6 (1949). The amendments accomplished this by substituting the lien-creditor test for the bona-fide purchaser test, but, since certain equitable liens were, under state law, good against lien creditors, it was felt necessary to add paragraph (6) of Section 60a, which deals specifically with the problem of equitable liens.[7]

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[7] Professor Gilmore points out that no one can be sure what is meant by "equitable lien." 1 Gilmore, Security Interests in Personal Property, 198-200. Comment (2) to Section 9-204 makes it clear that a security interest under the Code in after-acquired property is a legal rather than an equitable interest, since no further action by the secured party is required (American Law Institute Uniform Commercial Code, 1962 Official Text with Comments, 643-644).

It has been pointed out that Section 60 is aimed at the unsecured creditor or imperfectly secured creditor who tries to strengthen his position against other creditors when trouble seems imminent. See 1 Coogan, Hogan & Vagts, Secured Transactions Under the UCC 1393-1394 (1963). As indicated by *Rockmore* v. *Lehman, supra,* the creditor who establishes his position more than four months before bankruptcy is unaffected. In *Rockmore,* although the accounts came into being during the four-month period prior to bankruptcy, the secured party did not have to take any further action in order to perfect his interest in them. His legal position had been solidified prior to the four-month period. All that remained was for the debtor to earn the accounts.

More specifically, it has been suggested that the 1938 and 1950 amendments to Section 60 were aimed at three evils: the unrecorded mortgage, the equitable lien on presently-owned property, and those after-acquired property interests where some additional step such as recording or taking of possession was required. Compare *Eberly* v. *Dudley,* 314 F. 2d 8 (9th Cir. 1962). They were not aimed at publicly filed security interests in after-acquired property where no additional step was required to obtain and perfect the security interest. See Friedman, "The Bankruptcy Preference Challenge to After-Acquired Property Clauses Under the Code," 108 U. Penn. L. Rev. 194, 204 (1959). See also the testimony of Professor McLaughlin in the Hearings on the 1938 Act, Hearings before the Committee of the Judiciary of the House Studying the Revision of the Bankruptcy Act, 75th Cong., 1st Sess., Ser. 9, 123 (1937); and 2 Glenn, Fraudulent Conveyances and Preferences § 576 (1940 ed.).[8]

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[8] Compare *Joe Heaston Tractor and Implement Co.* v. *Claussen,* 59 N.M. 486, 287 P. 2d 57 (1955); *In Matter of Hayes,* 140 F. Supp. 444 (D. Alaska, 1956); *In Matter of Platt,* 4 C.C.H. Installment

C. Section 9-108 (O.R.S. § 79.1080).

Consistent with these views, the Permanent Editorial Board is of the opinion that within the limits set by Section 9-108 of the Code (O.R.S. § 79.1080) a security interest in after-acquired property created more than four months prior to bankruptcy which ripens during the four-month period is no more preferential under Section 60 than a contract right which ripens into an account during the four-month period.

Section 9-108 (O.R.S. § 79.1080) provides as a principle of state law that—

> "Where a secured party makes an advance, incurs an obligation, releases a perfected security interest, or otherwise gives new value which is to be secured in whole or in part by after-acquired property his security interest in the after-acquired collateral shall be deemed to be taken for new value and not as security for an antecedent debt if the debtor acquires his rights in such collateral either in the ordinary course of his business or under a contract of purchase made pursuant to the security agreement within a reasonable time after new value is given."

The Section makes it clear that, to the extent state law may be applicable, state law does not regard a security interest in after-acquired property as being given on account of an antecedent debt (1) if the secured party gives new value which is to be secured by such after-acquired

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Credit Guide 89033 (D.C. E.D. Pa. 1966), vacated on other grounds, 4 C.C.H. Installment Credit Guide 889-35 (Aug. 8, 1966); and *In re Goodfriend,* 4 C.C.H. Installment Credit Guide 89435 (E.D. Pa. 1964). All of these cases involved security interests in after-acquired property, some of which must have been acquired within four months of bankruptcy and in none of which was the preference issue raised.

property, and (2) if the debtor's interest in such after-acquired property arises in the ordinary course of his business. The Trustee argues on page 25 of his Brief that Rose City's security interest was not given for new value, since only a portion of the indebtedness secured by the security agreement was advanced on the date of the execution of the agreement. Even if this is so, there is little doubt that the releases of Rose City's perfected security interest in the accounts arising between November 22, 1963, and June 15, 1964, were new value within the specific language of Section 9-108. Nor has there been any dispute about the fact that the accounts outstanding on September 28, 1964, arose in the ordinary course of the Bankrupt's business.

Section 9-108 has been attacked as an effort to invade the province of the Bankruptcy Act itself. The Board asserts that it has no such purpose, and agrees that, if the policy of the Bankruptcy Act was contrary to Section 9-108, the policy of the Bankruptcy Act would control. The history of the Bankruptcy Act in the context of the personal-property security law in existence at the time the Bankruptcy Act was drafted strongly suggests that the policy of the Bankruptcy Act and Section 9-108 are in harmony.

In *Rockmore* v. *Lehman, supra,* the determination of whether the security interest in the accounts earned by the debtor during the four-month period was voidable turned entirely on the Court's interpretation of state law. In fact, the Court reversed itself when it changed its interpretation of the state law. To the extent that the intention of the Legislatures enacting the Code is important to the determination of the interaction between the Code and Section 60, that intention has been made clear in Section 9-108 (O.R.S. § 79.1080).

To the extent that there has been no clear interpretation of the application of Section 60 of the Bankruptcy Act to

a security interest in after-acquired property, we think that language used by Judge Friendly in connection with a problem under Article 2 of the Code is valid and applicable. In *United States* v. *Wegematic Corporation*, 360 F. 2d 674, 676 (2d Cir. 1966), he said:

> "We find persuasive the defendant's suggestion of looking to the Uniform Commercial Code as a source for the 'Federal' law of sales. The Code has been adopted by Congress for the District of Columbia, 77 Stat. 630 (1963), has been enacted in over forty states, and is thus well on its way to becoming a truly national law of commerce, which, as Judge L. Hand said of the Negotiable Instruments Law, is 'more complete and more certain, than any other which can conceivably be drawn from those sources of "general law" to which we were accustomed to resort in the days of Swift v. Tyson.' New York, N.H. & H. R. Co. v. Reconstruction Finance Corp., 180 F. 2d 241, 244 (2d Cir. 1950). When the states have gone so far in achieving the desirable goal of a uniform law governing commercial transactions, it would be a distinct disservice to insist on a different one for the segment of commerce, important but still small in relation to the total, consisting of transactions with the United States."

This view is echoed in *Rosenberg* v. *Rudnick*, 262 F. Supp. 635, 639 (D. Mass. 1967), where the Court said:

> "The Bankruptcy Act itself does not define antecedent debt. In view of the fact that the Uniform Commercial Code has now been adopted by 48 states, it would seem that the definition of §9-108 should be regarded as generally accepted and in accord with current business practice and understanding and hence applied in bankruptcy."

In *In re White,* 283 F. Supp. 208 (S.D. Ohio, 1967), another case dealing with an after-acquired property interest in a pool of collateral acquired under the Uniform Commercial Code, the Court concurred with the conclusion that Section 9-108 does not permit the evil which Section 60 seeks to prevent.

It has been suggested that the tests established by Section 9-108 come closer to the objectives of Section 60 than some of the rules expounded in early cases thereunder. See Hogan, "Games Lawyers Play with the Bankruptcy Preference Challenge to Accounts and Inventory Financing," 53 Cornell L.R. 553, 565 (April, 1968).

The Board believes that Section 9-108 (O.R.S. § 79.1080) provides the correct principles to be applied in this case both because it avoids the difficulties of applying the *strict test* and because it is entirely consistent with the fundamental objectives of Section 60.

V. The Transfer of the Accounts Occurred Prior to the Beginning of the Four-Month Period.

The District Court held that the accounts claimed by Rose City which came into existence during the four-month period were, for the purpose of Section 60, transferred to Rose City prior to the four-month period. In so holding it followed *Rosenberg* v. *Rudnick, supra,* which involved a pool of inventory rather than a pool of accounts. In both cases the loan was made, the security agreement was signed and the financing statement was filed more than four months prior to bankruptcy. In both cases this holding was opposed on the basis of the first sentence of Section 60a(2), which reads as follows:

> "For the purposes of subdivisions a and b of this section, a transfer of property other than real property

> shall be deemed to have been made or suffered at the time when it became so far perfected that no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract could become superior to the right of the transferee"—

and on the basis of Sections 9-303 and 9-204(1) of the Code (O.R.S. §§ 79.3030 and 79.2040(1)), which provide that a security interest cannot be perfected until it has attached and a security interest cannot attach until the debtor has rights in the collateral. The Court below agreed with the Court in *Rosenberg* that the making of the loan, the execution of the security agreement and the filing of the financing statement were all the steps that were necessary to "so far perfect" the secured party's interest in the collateral arising during the four-month period that no subsequent lien creditor could obtain superior rights (R. 96-98). It is clear under both the Code and the provisions of Oregon law relating to attachment and execution[9] that no subsequent lien creditor could obtain superior rights.

Both Courts supported this conclusion by reference to the "Mississippi River" or entity concept articulated by Judge Magruder in *Manchester National Bank* v. *Roche*, 186 F. 2d 827, 831 (1st Cir. 1951), in which he said:

> "By analogy it might be possible to treat a merchant's accounts receivable as a unit presently and continuously in existence, the component elements of which (the particular accounts) may be constantly changing, without affecting the identity of the *res;* so that a general assignment by way of security of

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[9] See O.R.S. Sections 29.170 and 23.410 and compare *William Iselin & Co.* v. *Burgess & Leigh, Ltd.,* 276 N.Y. Supp. 2d 659, 52 Misc. 2d 821 (Sup. Ct. 1967).

accounts receivable present and future might be deemed to create *in praesenti* a lien upon this enduring unit, the accounts receivable, which lien would persist as a floating charge upon such *res,* however much its component elements might change from time to time by the payment of old accounts and the creation of new ones."

It is submitted that these holdings are in full conformity with the objectives of Section 60.

VI. Conclusion.

The Referee's decision in this case is sharply inconsistent with Section 9-205 of the Code and, if reinstated, would seriously interfere with the development of simplified financing procedures envisaged by the Code. The decision of the District Court in Oregon, like similar decisions in Massachusetts and Ohio, is fully in accordance with the purposes and objectives of Section 60a. It meets the technical tests of Section 60a because the transfer of the collateral in dispute is deemed to have taken place prior to the four-month period. Even if the transfer is to be regarded as having taken place during the four-month period, however, the result is fully supported by pre-Code rules regarding substitution of collateral and by Section 9-108 (O.R.S. § 79.1080).

Respectfully submitted,

RUPERT R. BULLIVANT,

JAMES C. DEZENDORF,

JOSEPH McKEOWN.

Appendix

Figure 1

BILLINGS AND COLLECTIONS OF BANKRUPT, JUNE 15-SEPTEMBER 28, 1964.†

Period	Proceeds of assigned accounts collected and used by bankrupt			New billings			Outstanding advertising and circulation billings at end of period
	Advertising	Circulation	Total collections	Advertising billings	Circulation billings	Total billings	
							$144,255.70*
6/15-30	$47,478.68	$ 6,835.37	$54,314.05	$42,274.77	$57,341.58	$99,616.35	189,540.15
7/1-15	32,663.60	49,787.40	82,451.00	32,997.64	1,895.43	34,893.07	141,982.22
7/16-31	24,948.50	8,022.85	32,971.35	35,457.15	51,225.02	86,682.17	195,693.04
8/1-15	30,878.33	45,222.04	76,100.37	36,299.39	4,769.51	41,068.90	160,661.51
8/16-31	25,876.82	9,505.31	35,382.13	27,205.67	48,047.32	75,252.99	200,532.43
9/1-15	35,790.82	46,675.35	78,466.17	22,470.33	2,396.01	24,866.34	146,932.60
9/16-28	30,378.95	7,796.22	38,175.17	30,707.81	1,998.24	32,706.05	141,463.48
	$228,015.70	$173,844.54	$397,860.24‡	$227,412.76	$167,673.11	$395,085.87	

*Outstanding billings on June 15.

†Figures for each fifteen days are totals of the daily figures appearing in Exhibit 39.

‡This figure appeared in the Board's Brief in the District Court, was not disputed, and was found to be the amount collected (R. 100). The Trustee now argues that it may include credits and write-offs. Such credits and write-offs would be likely to reduce the total billings so that total collections from June 15 to September 28 would still be expected to exceed total billings (Trustee's Brief, 45).

Derivation of the Strict Test.

It is asserted on page 20 of this Brief that the following two substitution-of-collateral rules urged by the Appellant—

> 1. The new collateral must be transferred to the secured party either prior to or contemporaneously with the release of the old collateral (the "timing rule");
>
> 2. If the new collateral is of greater value than the collateral which is released, a voidable preference for the difference in value will result (the "value rule")—

can be combined for the purpose of this case into the following rule:

> Where a changing pool of collateral secures fixed indebtedness during the four-month period prior to bankruptcy, the collateral in which the secured party has a security interest on the date of bankruptcy is subject to attack on grounds of preference to the extent that its value on the date of bankruptcy exceeds the lowest value of the collateral pool during the four months prior to the bankruptcy of the debtor (the "*strict test*").

That the *strict test* does combine both the timing rule and the value rule can be demonstrated by considering the following three hypothetical cases involving a fixed loan which exceeds the value of the collateral. In each case at the beginning of the four-month period prior to bankruptcy the collateral consists of four slow but collectible accounts receivable each in the amount of $25,000.

(1) In the first case, one new account of $25,000 arises and is assigned to the secured party three months before bankruptcy. One month later the debtor collects in full

ne of the four original accounts and is permitted to use he proceeds. On the date of bankruptcy the three old acounts and the new account total $100,000. (2) The only ifference between the first case and the second case is hat the new account is in the amount of $30,000 instead f $25,000, so that the value of the collateral at bankruptcy otals $105,000. (3) In the third case the debtor collects ne of the four accounts three months before bankruptcy. ne day later a new $25,000 account arises and is assigned o the secured party so that on the date of bankruptcy he three old accounts and the new account which are unollected total $100,000.

In the first case the lowest value of the collateral during he four-month period is $100,000, which equals the value f the collateral on the date of bankruptcy. Here there s no preference because the old collateral was released fter the new collateral was assigned, satisfying the timng rule and because the new collateral had the same value s the old collateral, satisfying the value rule.

In the second case the lowest value of the collateral durng the four-month period is $100,000, which is $5,000 less han its value at bankruptcy, resulting in the preference f $5,000. This results from the violation of the value ule. In the third case the lowest value of the collateral s $75,000, resulting in a preference of $25,000. Here it is he timing rule that has been violated.

Under the *strict test,* once the outstanding balance of ccounts drops to any figure, there is no way that it can e brought back up to the $100,000 on a non-preferential asis by the mere addition of collateral, since all subseuent additions of collateral will be non-preferential only f they are followed by equal or greater releases of colateral. This is true under the *strict test* whether the drop o a low figure occurs in one step or by several steps.

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> 1. The new collateral must be transferred to the secured party either prior to or contemporaneously with the release of the old collateral (the "timing rule");
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> 2. If the new collateral is of greater value than the collateral which is released, a voidable preference for the difference in value will result (the "value rule")—

can be combined for the purpose of this case into the following rule:

> Where a changing pool of collateral secures fixed indebtedness during the four-month period prior to bankruptcy, the collateral in which the secured party has a security interest on the date of bankruptcy is subject to attack on grounds of preference to the extent that its value on the date of bankruptcy exceeds the lowest value of the collateral pool during the four months prior to the bankruptcy of the debtor (the "*strict test*").

That the *strict test* does combine both the timing rule and the value rule can be demonstrated by considering the following three hypothetical cases involving a fixed loan which exceeds the value of the collateral. In each case at the beginning of the four-month period prior to bankruptcy the collateral consists of four slow but collectible accounts receivable each in the amount of $25,000.

(1) In the first case, one new account of $25,000 arises and is assigned to the secured party three months before bankruptcy. One month later the debtor collects in full

one of the four original accounts and is permitted to use the proceeds. On the date of bankruptcy the three old accounts and the new account total $100,000. (2) The only difference between the first case and the second case is that the new account is in the amount of $30,000 instead of $25,000, so that the value of the collateral at bankruptcy totals $105,000. (3) In the third case the debtor collects one of the four accounts three months before bankruptcy. One day later a new $25,000 account arises and is assigned to the secured party so that on the date of bankruptcy the three old accounts and the new account which are uncollected total $100,000.

In the first case the lowest value of the collateral during the four-month period is $100,000, which equals the value of the collateral on the date of bankruptcy. Here there is no preference because the old collateral was released after the new collateral was assigned, satisfying the timing rule and because the new collateral had the same value as the old collateral, satisfying the value rule.

In the second case the lowest value of the collateral during the four-month period is $100,000, which is $5,000 less than its value at bankruptcy, resulting in the preference of $5,000. This results from the violation of the value rule. In the third case the lowest value of the collateral is $75,000, resulting in a preference of $25,000. Here it is the timing rule that has been violated.

Under the *strict test,* once the outstanding balance of accounts drops to any figure, there is no way that it can be brought back up to the $100,000 on a non-preferential basis by the mere addition of collateral, since all subsequent additions of collateral will be non-preferential only if they are followed by equal or greater releases of collateral. This is true under the *strict test* whether the drop to a low figure occurs in one step or by several steps.

A corollary of the *strict test* is the principle that, in a situation where the collateral is constantly changing, there can be no preference so long as the indebtedness is fully secured throughout the four-month period. If the indebtedness is fully secured throughout the period, it follows that the lowest value of the collateral during the period must equal or exceed the indebtedness. The Trustee concedes that a transfer made to a creditor who is fully secured is not preferential. Trustee's Brief, 22, Footnote 7.

In a case where both the secured indebtedness and the value of the pool of collateral change during the four-month period this test could be rephrased to make preferential that portion of the value of the collateral on the date of bankruptcy which exceeds an amount determined by subtracting from the indebtedness on the date of bankruptcy the greatest amount (if any) by which at any time during the four month period, outstanding indebtedness exceeded the then value of the collateral. Both tests are based on the hypothesis that any particular account or any particular item of inventory is treated as having one value throughout the time it is in the collateral pool.